

To: The Next President

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Re: Building America's
21st Century Infrastructure

In the not-too-distant past, the United States was the world's undisputed leader in public infrastructure. Ours was the nation with the best airports, the most comprehensive railway network, the most sophisticated communication and electricity grids, and an extensive interstate-highway system.

For generations of Americans, these highways, trains, and airports were symbols of our ingenuity, prosperity, and can-do spirit. But they also reflected something even deeper: a national commitment to individual freedom and unlimited horizons.

Today, this advantage is disappearing. One can see it not only in the spectacular failures of our aging bridges and levees, but also in the day-to-day grind of bottlenecked traffic, pothole-riddled roads, dysfunctional airports, and the vast stretches of our nation still unserved by advanced telecommunications networks.

All of these shortfalls represent areas in which we have fallen behind other advanced nations. Any American who has traveled in recent years to Western Europe or East

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Asia has noticed the improvements other leading nations have made: the fast inter-city trains of France; the state-of-the-art airports of China and Japan; the widely accessible high-bandwidth Internet connections of South Korea.

Then the American traveler comes home to the slow trains of Amtrak, the chronic delays of Kennedy Airport, and the dearth of high-speed Internet access in rural schools and hospitals. The overall effect is a limiting of American mobility, both physical and social. It is a contradiction of our basic interests and values.

This erosion of our public resources is a civic shame, a drag on our economic growth, and, in some cases, even a threat to safety. If we are to get America moving again, your administration and the new Congress will need to make key investments to reverse this decline.

The most straightforward explanation for this failure is a lack of adequate funding. U.S. spending on infrastructure, as a percentage of Gross Domestic Product (GDP), has declined by 50 percent since 1960. Spending today is now well below where it needs to be—and the cracks have, quite literally, begun to show.

While the American Society of Civil Engineers (ASCE) estimates the United States will need to raise \$1.6 trillion just to repair and maintain our existing infrastructure stock,¹ we are being out-spent by our competitors. The United States is currently investing less on infrastructure as a percentage of GDP than Europe, China, and many emerging economies. In total, emerging economies alone are likely to spend \$1.2 trillion on infrastructure in 2008.²

America spends only about 2 percent of

GDP per year on infrastructure investment (this includes federal, state, local, and private-sector spending). By contrast, that number is about 5 percent in Europe and between 9 percent and 12 percent in China.³ In developed economies, the average is about 3 percent of GDP, and for developing economies it is around 6 percent. While the United States is trying to make a dent in its massive repair bill, other countries are lapping us in new investment—further shrinking the competitiveness gap between America and the rest of the world.

U.S. Competitiveness Gap

With the economy slumping, fuel costs rising, and private capital looking for new investment opportunities, infrastructure projects can boost our global competitiveness and create jobs at the same time. Many studies have pointed to a positive correlation between such investment and economic growth.⁴

Economic analyses over the last 20 years have attempted to quantify those benefits and have come up with a wide range of estimates depending on how the funds were spent. Almost all analysts agree, however, that public spending generally produces “positive economic returns.”⁵ A recent World Bank study even estimates that under the right conditions, “a 1% increase in a country’s infrastructure stock is associated with a 1% increase in the level of GDP.”⁶

Infrastructure is defined as transportation (highways, roads, air, water, and rail), utilities (water, gas, electricity, and telecommunications), and some other public facilities such as schools, prisons, and the postal system. In short, it is the nerves, sinews, and muscles of our economy and our society. When these

networks and systems get fatigued and run down, it is impossible for America to operate at full health.

In order to understand the problem, we need to understand how the United States currently pays for what we have. In 2004, \$400 billion was spent on infrastructure, of which the federal government provided \$60 billion, or 15 percent of the total. State and local governments funded 42 percent, and the private sector covered the remainder.⁷

What is important to know here is that these three different funding sources tend to spend their money on very different things. For example, federal spending is dominated by transportation—nearly 50 percent of Uncle Sam’s infrastructure spending goes toward highways. State and local government spending is dominated by highways, schools, and water, which together account for nearly 80 percent of the state-and-local sector’s \$175 billion public works bill. Private-sector infrastructure spending is dominated by energy and telecommunications; these two spending categories alone account for nearly 80 percent of private infrastructure spending.⁸

Despite this *de facto* specialization, there is no clear mandate on how to set goals and allocate spending on infrastructure. Federal funding is subject to annual budgeting and therefore highly susceptible to congressional pork. Annual budgeting also means it can be difficult to design and fund projects that require a longer time horizon or serve a greater national interest.

State and local projects that depend on local taxes for support—like schools—can be severely affected by adverse local economic conditions that can make it difficult to raise funds. Even the private sec-

tor, despite the benefit of market efficiency, can be slow to explore new opportunities, such as renewable energy resources, when the current ones are still making considerable profits.

Untapped Opportunity

Public investment is needed, but it is clear that government cannot, and should not, shoulder the burden alone. As it happens, private capital investors are hungry for high-quality investment opportunities after the collapse of mortgage-backed securities and the turbulence in the equities markets.

In response to this market demand, banks and private equity firms have raised funds to invest in major infrastructure projects. According to McKinsey & Company, the world’s 20 largest private infrastructure funds have nearly \$130 billion under management, with 77 percent of it raised over the last two years alone.⁹

This represents an enormous opportunity for funding our infrastructure needs. One way to seize that opportunity is to create an American version of the European Investment Bank (EIB), which has a half-century track record of success in financing productivity-enhancing projects.

The EIB was founded under the terms of the 1957 Treaty of Rome as the long-term lending institution of the European Union (EU). The EIB is owned by the member states of the EU, who make an initial contribution to the bank’s capital reserve fund according to their relative GDP. Otherwise, the bank is fully self-financing, borrowing on the financial markets to issue loans, and does not take any funds from the EU budget. The EIB operates autonomously, is

a non-profit, and makes lending decisions based on the following charter criteria:

- Investments must help achieve EU objectives;
- These investments must be economically, financially, technically, and environmentally sound; and
- They should help attract other sources of funding (the EIB cannot lend more than 50 percent of the total cost of an individual project).

Because the EIB's shareholders are the EU member states, its debt carries the highest possible credit rating (AAA) on the money markets, allowing it to generate capital on very competitive terms. Borrowers range from small businesses to national governments. While repayment terms may vary, all loans must be paid back to the bank.

In 2007, the EIB raised €55 billion on the capital markets and made new loans totaling €47.8 billion¹⁰—85 percent of which went toward further improvements to EU airports, highways, bridges, railroads, and other vital infrastructure. The remainder supported development projects around the globe.

An American Investment Bank

Your administration should establish an American Investment Bank (AIB), following the model of the EIB. The AIB could be staked with an initial capital reserve fund from the federal government and one-time membership fees from the states.¹¹ The AIB could then raise funds for infrastructure loans by issuing debt instruments backed by the government's credit rating. The skyrocketing growth in private investment funds

shows that there is a large—and still untapped—market for infrastructure-backed assets. This market is a ready source of funds for public-private partnership in infrastructure investment.

The AIB, like the EIB, should have a charter that sets out clear investment goals. These should include the following:

- Projects should be evaluated based on sound economic criteria and their environmental impact;
- Such projects should promote community economic development and broad-based economic opportunity; and
- They should promote the maintenance and public safety of existing critical infrastructure.

Benefits

A self-financing institution like a new AIB could raise funds for infrastructure investment without raising taxes. In addition, such an entity—if given sufficient autonomy—could evaluate infrastructure projects based on sound economic criteria and not pork-driven local interests.

Unlike the current system of annual federal budgeting for projects, which encourages congressmen to find funds for local projects regardless of larger economic value, the AIB would raise its own funds and issue loans. This would give the bank an incentive to make loans to economically viable projects, since a failure to do so would expose the bank to the risk of default. The fact that the AIB would not rely on annual or continued federal financing means it would be free to evaluate loan proposals on their economic merits rather than on purely political terms.

These qualities of self-financing and autonomy would enable the AIB to allocate long-term capital more easily than annual budgeting can, and will have the added benefit of cutting down on wasteful public spending. The charter goals of the AIB would prohibit it from financing “bridges to nowhere,” because projects would have to promote economic development and be evaluated on sound economic principles.

Like the war bond program during World War II, AIB infrastructure bonds would allow ordinary Americans to “invest in America” to help meet the infrastructure challenge and promote responsible citizenship. In addition to the civic and patriotic benefits of such a program, Americans will benefit from the opportunity to purchase a new high-quality savings instrument.

Finally, the AIB would be ideally suited to make loans to joint public-private partnerships. This would make it easier for local communities to attract private partners, and

would allow states and localities to tap into the more than \$100 billion in private funds currently available for investment opportunities. Over time, the AIB could also provide technical advice to localities looking to reproduce previous AIB infrastructure projects.

Conclusion

America’s infrastructure is in need of significant repairs, but increased demand cannot be met by tax-based government funds alone. An American Investment Bank would be able to raise funds for infrastructure development, promote public-private partnerships, and allocate funds efficiently without being subject to some of the pitfalls of annual budgeting. In addition, offering infrastructure-backed bonds is a great way to encourage ordinary Americans to participate while raising funds without raising taxes. In short, this is a policy that you would do well to consider. There is much to gain—and no time to lose.

ENDNOTES

1. American Society of Civil Engineers, *Report Card for America’s Infrastructure*, <http://www.asce.org/reportcard/2005/index.cfm>.
2. “The Cracks are Showing,” *The Economist*, June 26, 2008; “Building BRICs of growth,” *The Economist*, June 5, 2008.
3. *Ibid.*
4. Congressional Budget Office, *Issues and Options in Infrastructure Investment*, May 2008.
5. *Ibid.*
6. “Building BRICs of growth,” *The Economist*, June 5, 2008.
7. Congressional Budget Office, *op. cit.*
8. *Ibid.*
9. Spellman, James, “Building on Strong Foundations,” *Financial Times*, March 13, 2008.
10. European Investment Bank, *Annual Report 2007, Volume II Financial Report*.
11. The Obama campaign is proposing a \$60 billion federal investment in a National Infrastructure Reinvestment Bank over 10 years, but this proposal applies mainly to transportation projects. It does not seem to call for the creation of an autonomous, self-financed institution along the lines of what is being recommended here.



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